



fatPROPHETS™

October 2008 NTA Release

1. Details of Performance and Net Asset Backing at Month end

The net asset backing ("**NTA**") of Fat Prophets Australia Fund Limited ("**Fat Fund**") as at 31 October 2008 was **\$0.8645 per share** on a before tax basis, calculated in accordance with ASX Listing Rule 19:12, and represents a decline of 8.28% over the month. By comparison, the Fat Fund's benchmark, the S&P/ASX 300 Accumulation Index decreased 12.88% in October 2008.

After adjusting for the impact of taxation on both realised and unrealised gains, the Fat Fund's after tax NTA at the end of October 2008 was **\$0.9247 per share**.

2. Performance Commentary

The major influences on the Fat Fund's performance versus the benchmark during the month of October 2008 were as follows (* denotes acquired during month):

Positive Influences			Negative Influences		
<i>Company</i>	<i>% move</i>	<i>Position</i>	<i>Company</i>	<i>% move</i>	<i>Position</i>
Altium	81%	Overweight	Telstra	-1%	Underweight
Beach Petroleum	7%	Overweight	GPT Group	-45%	Overweight
Incremental Petrol.	13%	Overweight	Macquarie Office	-63%	Overweight
NAB	-1.1%	Overweight	Tishman Speyer	-65%	Overweight
Wesfarmers	-25%	Underweight	Westfield	-1%	Underweight

In our last NTA announcement of 14 October 2008, we hypothesised that despite the obvious pervasive economic gloom, stocks were exceptionally cheap on a medium term view versus their fixed interest counterparts, but would obviously be subject to short term volatility. The last NTA release came amidst a month which was the sixth worst since the All Ordinaries index was constituted in something like its current format in 1936; the cumulative September and October decline of 23.6% is surpassed since 1936 only by the months bordering the October 1987 crash.

Since that piece was written, the S&P/ASX 300 index (capital not accumulation basis) has fallen a further 11.7%, despite having found an intermediate bottom on 28 October just below current levels. Of course, between then and now, we saw a 14.5% rally in this index amidst a general belief that shares had gotten "just too cheap" before the topical gloomy news took away investors' enthusiasm. In our view, it's a typical bottoming process – seen many times previously in three respects: inactivity, downgrades and capital raisings.

That many investors are saying "I know stocks are cheap but I'm frightened they'll fall further" and so stay away is exemplified by the significant declines in volumes now being seen on ASX with days of just above \$3billion of turnover against the more typical \$6billion plus previously seen. The secondary market for stocks is thin – a phenomenon usually seen at market nadirs.



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The earnings downgrade process has now started in earnest in the most logical places – operationally geared companies: discretionary retail, media and resources. Media in particular has been a key source of structural change ganging up with cyclical downturn to produce an environment for these corporations not seen for two decades, since a number of the domestic operators were loaded down with debt from over-priced acquisitions. This time, the debt is less but the operating leverage is just as savage.

The continuing decline in oil, gold and base metal prices – despite the offsetting influence of the declining A\$ – is leaving many of the mid tier producers hostage to increased financial stress. Analytical estimates have simply not caught up with the speed of decline in product prices, leaving 2009 and 2010 forecasts hopelessly optimistic. We are generally keeping our positions in the largest companies.

In the six weeks from the beginning of October, major Australian corporates have raised around \$10 billion of fresh capital – about 1.2% of market capitalisation (excluding underwritten DRP's). Close to 40% of this has come in the A-REIT sector (over 6% of its market capitalisation) to defray either excessive gearing or debt levels distorted by the collapse of the A\$. The raisings, as is always the case at this stage of the cycle, can be put into two baskets:

- the **strong** raising money because they can, with the proceeds to be used – alongside very cheap debt which is available to them – to pick off strategic assets and set the business up for another phase of organic growth – CBA, Sonic Healthcare, Stockland could probably be placed in this basket;
- the financially **weak**, who hold excellent assets under a stressed financial structure, but where investors will re-enter at a price. GPT Group is clearly an example of this type of transaction

These raisings start to establish the basis for the next upcycle, by enabling the strong companies to move corporately being (significantly) cheaper to buy assets or businesses through the listed market than by developing them from the ground up. Even the redoubtable Lowy family, with their enviable record of cycle timing (barring one media related blemish) appear to be hinting as such – in their core space. Hardly surprising when after falling close to 45% in eleven months to end September, the S&P/ASX 300 A-REIT index fell a further 25.5% in October. More intriguingly, Westfield, which makes up 43% of that index declined only 1.7% during the month, suggesting the residual 57% fell in value by a cumulative 43.5%. That's called competitive advantage.

Amidst the doom and gloom, there remain encouraging signs of credit markets freeing up amidst the torrent of liquidity being supplied. Whilst three month US T Bill rates are below 15 basis points at the time of writing, LIBOR is now not far above 2% and the spread between the two has more than halved from its peak.

In the past month, the Fat Fund has sold its positions in **Incremental Petroleum** and **Lihir Gold**, whilst reducing exposure to a small number of mid tier companies; this has provided funding to acquire a new position in **Wesfarmers**. The near 60% share price decline in this well managed conglomerate has provided the first opportunity in many years to acquire its shares at a decent discount to a conservatively struck sum of the parts valuation. Whilst we believe it is inevitable that Wesfarmers will tap the equity market at some stage to reduce their debt, in our view the quantum required, relative to equity capitalisation of the company is relatively modest and should not be excessively dilutive.

In addition, we operated the share buy back at its most aggressive since commencement, and acquired just over 750,000 shares during the month.

We look forward to meeting and presenting to shareholders at the Fat Fund AGM, being held at the Grace Hotel in Sydney on Friday 28 November at 10.30am. We hope to see you there.



3. Top 15 Holdings at 31 October 2008

Company	Symbol	% Weighting
BHP Billiton	BHP	12.62
National Aust. Bank	NAB	8.77
Westpac	WBC	7.36
Commonwealth Bank	CBA	7.17
ANZ Bank	ANZ	5.75
QBE Insurance	QBE	5.58
Woolworths	WOW	4.96
RIO Tinto	RIO	3.53
Beach Petroleum	BPT	3.07
Lion Selection	LST	2.86
Wesfarmers	WES	2.81
St George Bank	SGB	2.80
Washington H Soul Pattinson & Co LT	SOL	2.66
Everest Babcock & Brown Alt. Inv. Trust	EBI	2.13
Insurance Australia Group	IAG	2.06

Andrew Brown^a & Steve O'Hanna^a

14 November 2008

a: Andrew Brown and Steve O'Hanna are employees of Tidewater Investments Limited. A controlled entity of Tidewater Investments Limited, Tidewater Asset Management P/L (AFSL# 302802) currently manages the Fat Fund under a sub-contract agreement dated 24 May 2007 with fat Prophets Funds Management Australia P/L.

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